

H-3103-1 - FEES, RENTALS, AND ROYALTY

KeywordsIV. Lease Royalty ProvisionsA. General

Oil and gas leases with different royalty rate provisions have been issued in accordance with the various amendments of the MLA. The following is a synopsis of the MLA and its amendments affecting royalty. Each lease must be reviewed individually to determine the type of lease and the Act under which the lease was issued in order to determine the applicable royalty rate. For competitive and noncompetitive leases issued in accordance with the Reform Act, no specific royalty schedule is used. However, for leases issued under previous amendments to the MLA, certain royalty schedules were developed. For convenience, the following terms will be used, where applicable, to identify the various royalty schedules: Schedule "B", Schedule "C", and Schedule "D (sliding)". The basic requirements of these schedules and the appropriate action codes for ALMRS Entry are summarized in Illustration 6. Illustration 7 provides an explanation of each schedule. Schedule A (see Illustration 8) is applicable to certain noncompetitive leases and provides for a flat 12½ percent royalty on production removed or sold.

ROYALTY
RATES1. 1920 Act

The Mineral Leasing Act of February 25, 1920, established the issuance of prospecting permits for Federal lands. Under Section 13 of this Act, prospecting permits could be obtained covering those lands not within the known geological structure of a producing oil or gas field. The maximum size of a prospecting permit was 2,560 acres, and only one could be given to an individual on a single oil and gas structure or in an area, and not over three could be issued to an individual in the same State. These permits were issued for a period of 2 years and contained a drilling requirement that the permittee was to commence a well within 6 months, and within 1 year was to drill to a total depth of 500 feet, and within 2 years from the date of the permit, drill for oil and gas to an aggregate depth of not less than 2,000 feet unless oil or gas was discovered at a lesser depth. The prospecting permits contained no rental requirements and the royalty rate was 20 percent.

ROYALTY RATE -
1920 ACT

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Keywords

If it was established to the satisfaction of the Secretary that a valuable deposit of oil or gas had been discovered within the limit of the lands embraced within the prospecting permit, the permittee could apply for a lease. If the application was satisfactory, the applicant received a lease for one-fourth of the land embraced in the permit or a minimum of 160 acres, if that much acreage was contained in the permit area. The lease term was for 20 years at a 5 percent royalty rate. The lease rental became \$1 per acre. Also, under Section 14 of the Act, the lease provided for a preference right to renew such leases for successive periods of 10 years, each upon such reasonable terms as the Secretary might prescribe. These 5-percent leases were called the "a" leases. As to the remainder of the acreage in the permit, the permittee received a preference right to a lease on the remainder of the area at a sliding-scale rate of 12½ to 33½ percent on oil. These "b" leases also were issued for a term of 20 years with a right to renew for successive 10-year periods. For the most part, the previously mentioned sliding-scale leases require a gas royalty rate of 12½ percent, if total lease production was less than 3,000 thousand cubic feet (Mcf) per day, and 16½ percent if production was 3,000 Mcf or over. On gasoline and liquefied petroleum gas (LPG), in most cases, a flat 16½ percent royalty rate is required.

OLDER 20-YEAR
"a" LEASES -
5 PERCENT
ROYALTY RATE

OLDER 20-YEAR
"b" LEASES -
SLIDING SCALE
12½ - 33 PERCENT
ROYALTY RATE

The unappropriated land within the known geological structure of a producing oil or gas field was leased by the competitive bidding system under Section 17 of the MLA, and not over 640 acres could be obtained in a single lease. Competitive leases normally contained a sliding-scale royalty rate and were issued for a primary term of 20 years with a right to renew for successive 10-year periods. Rental on the "a" and "b" leases was \$1 per acre per year, with advance rental to be credited against royalties. Rental on competitive leases was also \$1 per acre per year, with advance rental to be credited against royalties. At the first renewal date after August 8, 1946, most of these "a" and "b" leases became subject to minimum royalty as discussed in Section III, above.

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Keywords2. 1935 ActROYALTY RATE -
1935 ACT

The Act of August 21, 1935, established a new leasing policy and authorized the issuance of new types of oil and gas leases. It terminated the policy of issuing prospecting permits and authorized the exchange of outstanding permits for leases. Leases were issued for the majority of the outstanding permits as of January 1, 1939. The remainder of the permits were exchanged for leases effective January 1, 1940. The Act of 1935 authorized the exchange of outstanding 20-year leases and 10-year renewals thereof for new leases at a royalty rate of not less than 12½ percent (actual leases issued contained a step-scale royalty on oil of 12½ percent to 32 percent). Such exchanges were made pursuant to Section 2(a) of the Act of 1935. All other leases (competitive and noncompetitive) were issued pursuant to Section 17 of the Act, as amended.

The Act of 1935 also directed that, in every case where one or more permits were issued covering a structure, the Secretary was to issue permits to all other applicants on the same structure even though one or more of the permittees had developed the structure into a producing oil or gas field, provided that such additional applications were filed prior to the development of the structure into a producing field. In this situation, the person making the discovery obtained a lease at a 5-percent royalty rate as long as the discovery was made under the permit, and royalty on the other permits that were issued subsequent to the discovery, but which had been applied for prior to discovery, was at a 10-percent rate. The Act of 1935 also provided that prior to termination of the permit that had been issued, the permittee had a preference right to exchange that permit for a lease. The permittee that made the discovery was still entitled to a 5-percent lease as a reward for discovery on one-fourth of the permit, and, on the remainder of the permit, had a preference right to a lease on that acreage at the sliding-scale rate.

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Keywords

All leases not issued upon discovery under a prospecting permit were issued under Section 17 of the MLA. Those leases issued pursuant to Section 17 carried a step-scale royalty rate on oil of 12½ percent to 32 percent, and 12½ percent on gas and liquid hydrocarbons when daily average gas production does not exceed 5,000 Mcf per well or 16½ percent when the daily well average is over 5,000 Mcf. By administrative action of May 3, 1945, the step-scale royalty rates on oil were reduced to 12½ to 25 percent (maximum of 25 percent instead of 32 percent) on leases thereafter issued.

The step-scale could be modified if the price was less than \$1 per barrel with such modification in proportion to the price. Rental on these leases was 25 cents per acre per year prior to production, and \$1 per acre per year after production. (Noncompetitive leases were further modified by the Act of July 29, 1942, that gave the leaseholder a preference right to a new lease if the lands were not included in the KGS.) Competitive leases issued under this Act were for an initial period of 10 years and so long thereafter as oil or gas is produced in paying quantities. Royalty under these competitive leases was established on a step-scale basis with a maximum rate of 32 percent. Subsequent Acts of 1943, 1944, and 1945 each granted 1-year extensions to leases covering lands in the KGS.

3. 1942 and 1945 Acts

The MLA revision of December 24, 1942, limited royalty to 1/8 (12½ percent) for 10 years following a discovery on a lease. The benefit was limited to lessees who drilled the discovery and also was limited to production from the new deposit.

ROYALTY RATE -
1942 AND
1945 ACTS

Circular No. 1595, issued May 3, 1945, amended the step-scale royalty rate provided under the Act of 1935 to limit the maximum royalty rate to 25 percent (see Illustration 7).

NOTE: The sliding-scale royalty rates still exceeded 25 percent and were unchanged.

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Keywords4. 1946 Act

The Act of August 8, 1946, limited the rate of royalty to 12½ percent on noncompetitive leases thereafter issued and on the existing leases as to production on oil and gas deposits discovered subsequent to May 27, 1941, except under competitive leases issued under the Act of August 31, 1935. It also substituted a \$1 per acre per year minimum royalty for advance rentals after discovery of oil or gas (see Section III, above). All noncompetitive leases issued subsequent to the Act of August 8, 1946, carry a 12½ percent royalty rate. This flat 12½ percent royalty rate often is merely specified in the terms of the lease form. In some cases, it is set forth in Schedule A (see Illustration 8), that was attached to the lease form. All leases issued between May 3, 1945, and August 8, 1946, as well as competitive leases issued after the 1946 Act (except leases issued in accordance with the Reform Act of December 22, 1987), carry a step-scale royalty rate of 12½ percent to 25 percent, that is often set forth as Schedule B (see Illustration 9). Leases issued between August 21, 1935, and May 3, 1945, are subject to a similar schedule, except the maximum royalty rate is 32 percent rather than 25 percent (see Illustration 7, page 3).

ROYALTY RATE -
1946 ACT

SCHEDULE A

SCHEDULE B

The 1946 Act also provided for royalty of 12½ percent on the production removed or sold from lands determined by the Director not to be within the productive limits of any oil or gas deposits on August 8, 1946. The various determinations issued by the Director under the 1946 Act essentially are rulings as to whether: (1) a discovery on a lease or unit after May 27, 1941, qualified as a discovery under the 1946 Act; (2) whether lands that may constitute all or part of the lease or unit were outside the productive limits of any oil or gas deposits on August 8, 1946. The oil or gas deposit existing on August 8, 1946, that covered the greatest areal extent is the governing factor.

At that time, Schedule C was applicable for renewals or exchanges of 5-percent royalty rate leases. Such leases that were renewed or exchanged prior to May 3, 1945, required a maximum royalty rate of 32 percent rather than 25 percent. Schedule C omits the step royalty rates of 13, 14, 15, 16, and 17 percent used in Schedule B, and jumps from 12½ percent to 18, 19, 20 percent, etc. The Schedule C royalty rate remains at 12½ percent until the average daily oil production exceeds 110 barrels.

SCHEDULE C

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Keywords

Schedule D can be applicable in a number of different cases since Item 2 on the schedule was filled in by the BLM to fit the case at hand. Schedule D normally was completed by typing in the royalty rate of the lease that was being renewed, provided the lease did not qualify under the 12½ percent royalty provision quoted in the upper part of Schedule D. SCHEDULE D

Section 15 of the Act allowed a person holding a lease on August 8, 1946, to elect to have his lease governed by the applicable provisions of the 1946 Act (see Section III.A, above).

5. 1960 Act

The Act of September 2, 1960, provided for noncompetitive leases to be issued for a term of 10 years and so long thereafter as they contained a well capable of producing oil or gas in paying quantities. Such leases were issued with a flat royalty rate of 12½ percent and a rental requirement of 50 cents per acre per year payable in advance. Competitive leases issued under the 1960 Act were for a term of 5 years and so long thereafter as the lease contained a well capable of producing oil or gas in paying quantities. The rental requirement for a competitive lease was \$2 per acre per year, and royalty was a step-scale royalty ranging from 12½ percent to 25 percent (Schedule B). ROYALTY RATE
1960 ACT

6. Mineral Leasing Act for Acquired Lands of August 7, 1947

The leasing of acquired lands for oil and gas is covered by the Act of August 7, 1947. Section 3 of the Act provides that oil and gas deposits within the acquired lands covered by the Act may be leased by the Secretary under the same conditions as contained in the leasing provisions of the Mineral Leasing Act of 1920, as amended. Section 10 of the Act of 1947 provides that the Secretary may prescribe such regulations as are necessary to carry out the purposes of the Act, and regulations shall be the same as those prescribed under the mineral leasing laws to the extent that they are applicable. Accordingly, the provisions in 43 CFR Parts 3100, 3110, 3120, 3160, and 3180 are applicable to both public domain and acquired lands. ACQUIRED LANDS
ACT OF 1947

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Keywords7. Federal Onshore Oil and Gas Leasing Reform
Act of December 22, 1987ROYALTY RATE -
1987 REFORM ACT

The Reform Act established a system requiring that all lands eligible and available for leasing must initially be offered by competitive sale. If a bid for a parcel is not received at a competitive oral auction, and the parcel was not subject to a presale noncompetitive lease offer, the lands in the parcel become available for postsale noncompetitive offer beginning on the first day following the last day of the competitive sale. Following a 2-year period from the date of the sale, if the lands in the parcel have not issued under a noncompetitive lease, the lands became subject again to leasing only through the competitive system. The Reform Act established rental in the amount of \$1.50 per acre for the first 5 lease years and \$2 per acre for subsequent lease years. The Reform Act continued the primary term of competitive leases as 5 years and the primary term for noncompetitive leases for 10 years. However, the Energy Policy Act of October 24, 1992 (P.L. 102-486), changed the competitive lease primary term to 10 years, the same length as for noncompetitive leases. Royalty rates required by the Reform Act are to be not less than 12½ percent for both lease types. The leasing regulations implementing the Reform Act require a flat 12½ percent royalty rate.

For exchange and renewal leases issued on or after the regulations of June 17, 1988, the royalty rate is a flat 12½ percent.

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B. Step-Scale LeasesKeywords

Examples of the step-scale royalty schedules (Schedules "B" and "C") used for Federal public domain oil and gas leases are provided in Illustration 9.

STEP-SCALE
ROYALTY
SCHEDULES

The gas royalty rate under step-scale leases is based on the average lease production per well per day for a calendar month using a 28-, 29-, 30-, or 31-day month without considering the actual number of days that the lease produced gas. Thus, the gas royalty rate for step-scale leases is to be determined based on the number of days in the calendar month regardless of the number of days that the wells produced, and each gas well that produced any gas during the month is to be counted. Gas royalties will be either 12½ percent or 16½ percent depending on this average production per well per day.

STEP-SCALE GAS
ROYALTY RATE

For example, a Schedule "B" lease having the following gas production from gas wells during April would have its royalty rate for gas computed as follows:

<u>Well No.</u>	<u>Days Produced</u>	<u>Total Mcf</u>
A	1	10,000
B	9	50,000
C	30	310,000
<u>D</u>	15	<u>300,000</u>
4 - Total wells	Total Mcf - 670,000	

Royalty Rate = 670,000 Mcf ÷ (4 wells x 30-day month)
5,583 Mcf/well/day

Royalty Rate (from Schedule B) = 16½ percent

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KeywordsSTEP-SCALE OIL
ROYALTY RATE

The oil royalty rate under step-scale leases is generally based on the average production of oil per well per day for the calendar month. Oil wells are to be counted as prescribed in 43 CFR 3162.7-4. The total oil production (sales) for the month is to be divided by the number of countable wells, and the figure thus obtained is to be divided by the number of days in the month to obtain the average daily production per well. However, when initial production of the leasehold is made during the month or when, for a previously producing leasehold, no well produced for 15 days or more, royalty is to be computed on the basis of actual producing well days. Oil royalties will vary from 12½ percent to 25 percent or 32 percent, depending on this average daily production and applicable royalty schedule.

For example, a Schedule "B" lease having 5 wells counted as producing every day during July (31-day month) and a total monthly lease production of 20,000 barrels will have a royalty of 18 percent calculated as follows:

20,000 barrels - 5 wells - 31 days = 129 barrels/well/day

Royalty Rate (from Schedule B) = 18 percent

20,000 barrels x 18% = 3,600 Royalty Barrels

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C. Sliding-Scale LeasesKeywords

Illustration 10 provides an example of the sliding-scale royalty schedule (Schedule "D"). Illustration 11 provides an explanation of the calculation of sliding-scale royalty.

SLIDING-SCALE
ROYALTY
SCHEDULE

For sliding-scale leases, the gas royalty rate is based on the total gas produced or allocated to the lease from all sources and is calculated on a 28-, 29-, 30-, or 31-day month, as the case may be, without considering well count or the actual number of days that the lease produced gas. For example, if a lease produced gas 2 days in April that totaled 15,000 Mcf, the royalty rate would be 12½ percent based on an average daily production of 500 Mcf (15,000 Mcf divided by 30 days). Gas royalties will be either 12½ percent or 16½ percent depending on whether the average production thus determined is greater or less than 3,000 Mcf per day.

SLIDING-SCALE GAS
ROYALTY RATE

The oil royalty rate under sliding-scale leases is computed by determining the average production per well per day and then applying a specific royalty rate to certain portions of the average production. For example, if the sliding-scale royalty rate of 12½ to 33½ (or 25) percent on oil above 30° Baume is applicable and the average daily well production for the month was 50 barrels, royalty would be 12½ percent on the first 20 barrels and 16½ percent on the next 30 barrels or a total of 7½ royalty barrels. Oil wells are to be counted as prescribed in 43 CFR 3162.7-4.

SLIDING-SCALE OIL
ROYALTY RATE

In cases where oil production from a sliding-scale lease or from a participating area with such a lease varies in gravity from above and below 30° Baume, API gravity is to be used instead of Baume. A volume weighted average royalty rate will be computed from the runs of the two gravity classes and such rate applied to the runs for the calendar month.

NOTE: The royalty rate schedule attached to some renewal and exchange leases was inadvertently labeled as Schedule "D" when, in fact, the royalty rate schedule was actually a "C" schedule. Some of these leases are located in Montana and Wyoming, and there may be other such exchange or renewal leases in the States of California, Colorado, and New Mexico.

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D. 12½ Percent DeterminationsKeywords

The 1946 revision of the MLA also provided for a royalty rate of 12½ percent on the production removed or sold from lands determined not to be within the productive limits of any oil or gas deposits on August 8, 1946. The various determinations issued in accordance with the 1946 Act essentially are rulings as to: (1) whether a discovery on a lease or unit after May 27, 1941, qualifies as a discovery under the 1946 Act, or (2) whether lands that may constitute all or part of the lease or unit are outside the productive limits of any oil or gas deposits on August 8, 1946. The greatest areal extent of the oil or gas deposit existing on August 8, 1946, is the governing factor.

12½ PERCENT
ROYALTY
DETERMINATIONS

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E. Effects of UnitizationKeywordsEFFECTS OF
UNITIZATION
ON ROYALTY RATE

Generally, the royalty settlement provisions in the normal unit agreement provide that royalty due the United States shall be computed in accordance with the operating regulations as to all unitized substances allocated to the unitized Federal land at the royalty rate specified in the individual lease, and that each participating area is to be considered as a single lease.

As a general rule for production under a unit agreement, oil royalty rates for step-scale and sliding-scale leases and gas royalty rates for step-scale leases are based on the total number of countable wells in and total production from a given participating area.

For sliding-scale leases, such rates must be based in each case on the total amount of gas allocated to or produced from the lease from all sources within and without the unit.

If a dually completed well is producing from two participating areas, it is to be counted as a well in each of the areas, if otherwise qualified. When wells are multiple-completed in a participating area, and a zone is determined to be noncommercial under the unit agreement, the completion in the participating area is to be counted as a well for the participating area and the well also is to be counted as a well for the noncommercial zone.

Unless specifically permitted by the unit agreement, any well located outside of a participating area is not to be counted for participating area royalty purposes. However, a portion of such a well may be counted if a corresponding portion of the well's production is allocated to the participating area.

Many older unit agreements contain special royalty provisions that amend the unitized leases. Accordingly, the specific provisions of the unit agreement must always be reviewed prior to determining individual well counts and royalty rates.

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KeywordsF. Effects of Communitization

The royalty rate for oil and condensate on leases subject to a step-scale or sliding-scale royalty rate shall be determined separately for the production from communitized wells and for the production from noncommunitized wells.

EFFECTS OF
COMMUNITIZATION
ON ROYALTY RATE

For a step-scale lease, the royalty rate for gas shall be determined separately as to production from each CA to which the lease is committed, and determined separately as to any noncommunitized lease production. For a sliding-scale lease, the rate of royalty applicable to gas production shall be determined by dividing the sum of all communitized production allocated to the lease and any noncommunitized production by the number of days in the month.

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KeywordsG. Bond Demands for Royalty Liabilities

When the MMS determines that royalty liabilities have occurred, i.e., insufficient royalty monies have been received, such royalty (including penalty and interest charges) and/or reclamation costs that are submitted in response to a bond demand are to be paid to the BLM in some form of guaranteed remittance. The BLM is to provide same-day confirmation receipt to the MMS by telefax or overnight mail for the royalty, penalty, and interest monies owed to the United States. The MMS monies are to be transferred to the BLM Service Center by Online Payment and Collection System (OPAC), Form 1372-5, so that the MMS can access the data within 5 working days of the payment's receipt. The receipt of the money by the BLM stops accrual of interest charges for the amount paid. Receipt of full payment by the BLM stops accrual of penalty charges. (See Handbook 3104-1, for bond collection procedures.)

BOND DEMANDS
FOR ROYALTY/
RECLAMATION
COSTS ARE
PAID TO BLM